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SIPDIS

SENSITIVE

TREASURY FOR A/S GLASER

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SUBJECT: SCENESETTER CABLE FOR VISIT OF TREASURY ASSISTANT SECRETARY GLASER

SIPDIS

REF: Brasilia 2082

1. (U) The United States Mission in Brazil warmly welcomes your August 20-23 visit to Brasilia. We are currently working with your staff on the logistical arrangements for your travel. Embassy has requested meetings for your delegation with counterparts at the Finance, Justice, and Foreign Ministries; the Central Bank; and Brazil's Financial Intelligence Unit (COAF). In addition, we are scheduling a press availability on the afternoon of August 23 and meetings with various elements of the Embassy Country Team.

2. (SBU) Your visit comes in the midst of Brazil's worst political scandal in more than 20 years. Congressional deputies from President Lula's governing coalition stand accused of accepting bribes, while officials from the President's party (the PT) are alleged to have engaged in influence peddling. The PT's slush fund financing of various political campaigns has highlighted the need for the government to tighten financial controls and bolster the staff of its fledgling Financial Intelligence Unit. Already, proposals are circulating within the GOB to include tax evasion and off-the-books financing as predicate offenses for the crime of money laundering. In addition, the Brazilians are examining interagency the idea of buttressing the current civil penalties banks face for failing to report suspicious transactions with criminal ones. While neither of these proposals has yet made it to Congress, once the Lula Administration submits these bills given the prevailing political climate we could see quick legislative action.

3. (SBU) In your public statements on money laundering/terrorism finance, we recommend that you underscore the years of useful cooperation between USG and Brazilian law enforcement authorities on these issues - while emphasizing that your visit is not connected in any way to the ongoing political scandal. You might want to note that your visit is part of a continuing series of consultations (both bilateral and multilateral) between anti-money laundering/terrorism finance officials in both countries. Brazilian audiences will likely focus more on the money laundering aspects of your message as even among government interlocutors here terrorism finance does not have a high profile. Given the sensitivities surrounding the Tri-Border area, you may want to limit your press activities when you are in that region.

4. (SBU) Below is some further background information on the economic and political situation in Brazil today. We look forward to exploring these themes and others during the course of your visit.

FOREIGN POLICY

5. (SBU) President Lula has run an activist foreign policy with a focus on South America, forging alliances with other mid-sized powers (South Africa, India) as well as other third world countries. He has moved to revitalize Mercosul as a trading bloc and has sought a regional approach to the FTAA talks. Indeed, given its size and natural resources, Brazil has long seen itself as the natural leader of the region (even if that perception is not shared by many of its neighbors). In February 2005, Lula signed a "strategic alliance" with Venezuela's Hugo Chavez to promote joint energy and infrastructure projects, as well as possible purchases by Venezuela of Brazilian defense articles.

6. (SBU) Emblematic of Brazil's rising self-confidence on the world stage is its tenacious pursuit of a permanent UN Security Council (UNSC) seat. Brazil and other G4 states (India, Germany, Japan) are pressing now for votes on a resolution on UNSC reform. This stance is at odds with the USG position, which wishes to defer UNSC reform until after other changes in the UN systems, and which currently endorses Japan's UNSC bid. Brazil leads the UN peacekeeping force in Haiti with 1,200 troops on the ground there, and is also spearheading a "G-20" group of developing nations. Brazil has a long tradition of commitment to the UN and

other multilateral institutions. Many Brazilians are therefore deeply concerned by the war in Iraq, viewing it as a sign of U.S. unilateralism. President Lula voiced public opposition to the war, although this opposition never jeopardized bilateral relations and both sides continue to work on the broader bilateral agenda. Finally, Brazil is a player in high-profile global issues such as health (AIDS, pharmaceuticals) and the environment. However, its stances on these issues (such as the possible compulsory licensing of anti-AIDS drugs) has at times not been welcome to USG policymakers.

17. (SBU) Brazil's self-confidence has changed the tone of its relationship with the U.S., sometimes in ways to our liking, sometimes not. It helped keep issues like our requirements that Brazilian airlines furnish passenger data or our insistence on stronger IPR enforcement from blowing up into political food fights. The GOB worked quietly with us on the timing and details of its shoot-down program to accommodate our statutory requirements. Nevertheless, hypersensitivity on issues viewed as infringing on Brazil's sovereignty can get out of hand and may be seen as signs of political immaturity. Many Brazilians believe the U.S. has designs on the Amazon. Our fingerprinting of visitors to the U.S. drew reciprocal treatment for Americans here; visa and immigration issues remain sensitive points.

PRESIDENT LULA

18. (U) President Luiz Inacio Lula da Silva was inaugurated in January 2003 after a career as a Sao Paulo metalworker and labor leader. He founded the left-of-center Workers' Party (PT) in 1980 and lost three presidential campaigns before winning in the October 2002 elections. Lula can run again in October 2006, and recent polls give him a sizeable lead over potential challengers. He has traveled extensively in pursuit of a higher international profile for Brazil. He has met President Bush several times and the two have a good rapport. Despite the common perception that Lula's social agenda, including his trademark "Zero Hunger" program, has not delivered much, Lula's popularity remains high and remarkably detached from that of his government. He is seen as honest, optimistic and inclusive, particularly towards the lower classes and marginalized sectors. Lula often seeks a range of opinions on policy, making a point of consulting labor, civil society, business leaders, and state governors. Since the mid-1990s, the PT party has steadily moderated its leftist positions and moved towards the center, forming alliances with parties from the left to the right. This has caused some grumbling from the PT's left wing but made the party far more electable.

19. (SBU) During recent months the Lula Administration has been beset by a political crisis as interlocking influencing peddling/vote-buying scandals continue to unfold. The President's Chief of Staff has resigned his post, Lula has embarked upon a series of cabinet shuffles, and a number of high-level officials in Lula's party and his party's coalition have departed. Central Bank President Meirelles may depart the government soon (due to unrelated allegations against him) though Finance Minister Palocci appears well-entrenched. Still, a July 2005 poll shows that Lula's approval rating stands at 60%, and, so far, the scandals have not punished Brazil in the international markets. Lula's popularity reached a nadir of 54% in June 2004, when the public seemed to lose confidence in his fiscal austerity program and in the face of weak 2003 GDP growth and stubbornly high unemployment. Overall, confidence in the administration has rebounded as the economy improved, although the recent corruption scandals still may take a toll. The public's top concern -- crime and public security -- has not notably improved under this administration. The opposition will use these shortcomings and scandals to try to deny Lula any legislative victories in hopes of eroding Lula's popularity prior to the October 2006 elections.

ECONOMIC DEVELOPMENTS

10. (U) Brazil's economy, aided by a benign international environment, should have another solid year in 2005. GDP growth of 5% in 2004 has coupled with booming exports, healthy external accounts, inflation under control, decreasing unemployment and reductions in the debt-to-GDP ratio. President Lula and his economic team have implemented prudent fiscal and monetary policies and pursued necessary microeconomic reforms. In March 2005, the Brazilian government declined to renew its Stand-by Agreement with the IMF and in mid-July it announced that it would pay early US\$5.12 billion in Standard Reserve Facility payments due by March 2006.

11. (U) Brazil has made progress but significant vulnerabilities remain. Despite registering its first year-on-year decline in 2004, Brazil's (largely domestic)

government debt remains high, at 52% of GDP. Total foreign debt, while falling, is still large in relation to Brazil's modest export base. Over time this concern will be reduced by healthy export growth, which has anchored the positive trade and current accounts. Personal incomes improved in 2004 after a significant decline over the previous decade. Income and land distribution remains skewed.

¶12. (U) Sustaining high growth rates in the longer term depends on the impact of President Lula's structural reform program and efforts to build a more welcoming climate for investment, both domestic and foreign. In its first year, the Lula administration passed key tax and pension reforms to improve the government fiscal accounts. Judicial reform and an overhaul of the bankruptcy law, which should improve the functioning of credit markets, were passed in late 2004, along with tax measures to create incentives for long-term savings and investments.

¶13. (U) Public-Private-Partnerships, a key effort to attract private investment to infrastructure, also passed in 2004. Labor reform and autonomy for the Central Bank are on the agenda for 2005. Despite this well-considered reform agenda, much remains to be done to improve the regulatory climate for investments, particularly in the energy sector; to simplify tortuous tax systems at the state and federal levels; and to further reform the pension system. Prospects for much of this reform agenda are dim for the remainder of Lula's term.

TRADE POLICY -----

¶14. (U) President Lula has made economic growth and poverty alleviation top priorities. Export growth figures prominently in plans to generate growth and reduce what is seen as a vulnerability to international financial market gyrations. To increase exports, the government is seeking access to foreign markets through trade negotiations and increased export promotion as well as government financing for exports.

¶15. (U) To increase its international profile (both economically and politically), the Lula administration is seeking expanded trade ties with developing countries, as well as a strengthening the Mercosul customs union with Uruguay, Paraguay and Argentina. In 2004, Mercosul concluded free trade agreements with Colombia, Ecuador, Venezuela and Peru, adding to its existing agreements with Chile and Bolivia to establish a commercial base for the newly-launched South American Community of Nations. This year Mercosul is pursuing free trade negotiations with Mexico and Canada and hopes to be able to resume trade negotiations with the EU. The trade bloc also plans to launch trilateral free trade negotiations with India and South Africa, building on partial trade liberalization agreements concluded with these countries in 2004. China has increased its importance as an export market for Brazilian soy, iron ore and steel, becoming Brazil's fourth largest trading partner and a potential source of investment.

DOHA AGENDA - WTO -----

¶16. (SBU) Brazil leads the G-20 group of developing countries that is pressing for agricultural trade reform in the WTO Doha Development Agenda negotiations. Brazil's assertive leadership of the G-20 was blamed in some quarters for causing the failure of the WTO Cancun Ministerial in September 2003. Since then, Brazil has been more constructively engaged in the Doha Round as a member of the "Five Interested Parties" informal group, although many of its positions are still at odds with U.S. interests. In May 2005, Brazil's current representative to the WTO, Ambassador Luiz Seixas Correa, was defeated by former EU Trade Commissioner Pascal Lamy for the position of WTO Director General; Seixas Correa will be replaced by Ambassador Clodoaldo Huguene in September. Brazil is expected to maintain its assertive stance in the Doha Round on agricultural trade reform while taking more defensive postures in the discussions covering industrial products and services.

FREE TRADE OF THE AMERICAS - FTAA -----

¶17. (SBU) The U.S. and Brazil have been co-chairs of the FTAA ("ALCA" in Portuguese) talks since 2002. It has been a difficult period, rife with uncertainty over Brazil's commitment to the talks. While the Lula administration shed the extreme anti-FTAA rhetoric of the 2002 presidential campaign, it has not embraced the FTAA as a priority. Strong Brazilian commercial interests have yet to overcome these ideological hurdles to what is viewed as a "U.S.-led initiative."

118. (U) During the FTAA Ministerial in Miami in November 2003, the U.S. and others agreed to a new framework for negotiations to accommodate the sensitivities of Mercosul countries, principally Brazil. The compromise allowed countries to assume different levels of commitments, but guaranteed that there would be a common set of rights and obligations covering all the original areas of negotiation. Following the Miami Ministerial, negotiations to define the "common set" have not been successful. U.S. and Brazilian negotiators met in January and in February 2005 to explore prospects for resuming negotiations, but the process has not moved forward, in part due to Mercosul's continued interest in pressing for U.S.-Mercosul negotiations. Brazil is slated to host the next FTAA ministerial meeting, but no date has yet been set.

REFORM AGENDA

119. (U) In 2003, Congress passed Lula's key reforms to the public sector pension system and the tax code. The 2004 legislative season was not very productive, in part because of a political scandal early in the year followed by campaigning for the October municipal elections. In December 2004, several key bills passed into law, including a reform of the judicial system, a modern bankruptcy law, and Public Private Partnerships to fund infrastructure projects. In March 2005, a law to legalize biotechnology crops and stem cell research passed. The Lula administration has been less successful in combating crime, poverty, and decaying infrastructure. The flagship "Zero Hunger" program has reached only a fraction of the estimated 50 million Brazilians living in poverty. The administration was also slow to make progress on agrarian reform. Other bills awaiting attention this session include: further judicial reforms, Central Bank autonomy, and a reform of political parties and campaign funding.

AGRICULTURE

120. (U) Agriculture is a major sector of the Brazilian economy, and is key for economic growth and foreign exchange. Agriculture accounts for 13% of GDP (and 30% when including agribusiness) and 40% of Brazilian exports. Brazil enjoyed a positive agricultural trade balance of US\$34 billion in 2004. Brazil is the world's largest producer of sugar cane, coffee, tropical fruits, frozen concentrated orange juice (FCOJ), and has the world's largest commercial cattle herd (50% larger than the U.S.) at 170 million head. Brazil is also an important producer of soybeans (second to the United States), corn, cotton, cocoa, tobacco, and forest products. The remainder of agricultural output is in the livestock sector, mainly the production of beef and poultry (second to the United States), pork, milk, and seafood.

LINEHAN